

Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. IV

In the matter of

Appeal No. 36 of 2016

- (i) Mr. Aehsun M.H. Shaikh
 - (ii) Mr. Ahmed H. Shaikh
 - (iii) Mr. Nasir Ali Khan Bhatti
 - (iv) Mr. Usman Rasheed
 - (v) Mr. Farrukh Hussain
 - (vi) Mr. Yasir Habib Hashmi
 - (vii) Mr. Munir Alam
- ...Appellants
- (Appellant No.(i) Chairman, Appellant No.(ii) Chief Executive and
Appellants No. (iii) to (vii) all directors of Azgard Nine Limited)

Versus

Mr. Abid Hussain ED (CSD), SECP

..Respondent

Date of Hearing 21/09/16

Present:

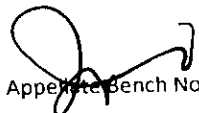
For the Appellants:

- (i) Mr. M. Umar Suhaib Pirzada, Counsel
- (ii) Mr. Faisal Iqbal Khan, Counsel

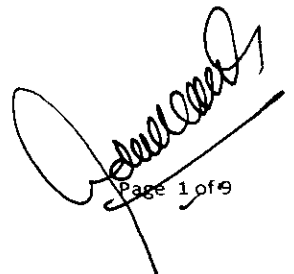
For the Respondent:

- (i) Ms. Amina Aziz, Director (CSD)
- (ii) Mr. Aqeel A. Zeeshan, Joint Director (CSD)

ORDER


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1. This order is in appeal No. 36 of 2016 filed under section 33 of the Securities and Exchange Commission of Pakistan (Commission) Act, 1997 against the order (Impugned Order) dated 11/05/16 passed by the Respondent.
2. The brief facts of the case are that Azgard Nine Limited (Company) filed an application dated 30/09/15 seeking Commission's approval for exemption from consolidation under section 237 of the Companies Ordinance, 1984 (Ordinance) in respect of its subsidiary Montebello S.R.L (Montebello) due to bankruptcy of Montebello. The Company along with the aforesaid application submitted an order of the Italian Court as evidence. Perusal of the aforesaid order revealed as under:
 - (i) The bankruptcy was filed on 12/06/14; and
 - (ii) The Court passed order on 22/12/14 for sealing Montebello and appointing trustee.

Perusal of the annual audited financial statements (Accounts) of the Company for the year ended 30/06/14 and subsequent interim accounts for the periods ended 30/09/14, 31/12/14 and 31/03/15 revealed that the Company neither disclosed the aforementioned material facts along with other consequences of bankruptcy of Montebello, if any, nor did it assess the investment, goodwill and other balances disclosed in the respective accounts in respect of Montebello for impairment in the light of such facts. The following balances in respect of Montebello were appearing in Company's respective accounts:

Period Ended	Mar 31, 2015	Dec 31, 2014	Sep 30, 2014	June 30, 2014
Trading transactions				
Sales	30,641,588	30,941,588	30,580,299	648,263,567
Balance outstanding	348,506,721	387,704,392	988,373,277	963,354,964
Past due by more than one year				
				293,180,320



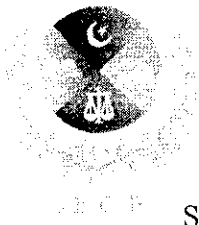
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Intangible Assets					
Goodwill-Montebello	692,874,468	767,048,212	817,167,305	844,487,927	
Long term investments					
Cost			2,625,026,047	2,625,026,049	
FV Adjustment			2,625,026,047	2,625,026,049	
Impairment					
Opening balance			(1,164,365,312)	(1,164,365,212)	
Charge for the year			(11,253,066)	(11,253,066)	
Accumulated impairment			(1,175,618,378)	(1,175,618,378)	
Net carrying value	1,449,407,671	1,449,407,671	1,449,407,669	1,449,407,671	

(2013; *1.126 million and **38.768 million)

In view of the aforementioned facts, the Accounts of the Company for the year ended 30/06/14 and its subsequent interim accounts, prima facie, omitted material information about latest status of operations of Montebello. Moreover, the said accounts were, prima facie, misstated since impairment of trade debts, equity investment and goodwill was not adequately and appropriately assessed and accounted for as per requirements of International Accounting Standard (IAS) 39 and IAS 36, keeping in view the objective evidence of impairment on the respective reporting dates due to bankruptcy filed by Montebello.

3. Show Cause Notice (SCN) dated 09/10/15 was issued to the directors of the Company including the Chairman and Chief Executive (Appellants) advising them to explain their position as to why penal action may not be taken against them under section 492 of the Ordinance. Mr. Muhammad Ijaz Haider, Company Secretary, through letter dated 22/10/15 requested for extension in time for submission of reply to the SCN. The Appellants were given time till 10/11/15 for submitting the response. The written reply to the SCN was submitted by the Appellants through letter dated 10/11/15.



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Subsequently, the case was fixed for hearing on 30/11/15, 30/12/15 and 18/01/16 but was adjourned on Appellants' repeated requests. Finally, the hearing was held on 16/03/16. Mr. Ijaz Haider and Mr. M. Zahid Rafiq appeared on behalf of the Appellants and mainly reiterated the earlier written submissions.

4. The Respondent dissatisfied with the response of the Appellants in exercise of the powers conferred by section 492 of the Ordinance imposed a penalty of Rs.1,300,000 in aggregate on the Appellants. The Appellants were directed to deposit the fines in the following manner:

Name of Respondents	Amount in Rupees
Mr. Ahmed H. Shaikh, Chief Executive	300,000
Mr. Yasir Habib Hashmi	300,000
Mr. Munir Alam	300,000
Mr. Aehsun M.H.Shaikh, Chairman	100,000
Mr. Nasir Ali Khan Bhatti	100,000
Mr. Usman Rasheed	100,000
Mr. Farrukh Hussain	100,000
Total	1,300,000

5. The Appellants' Counsel preferred the appeal on the following grounds:

- a) The annual, half yearly and quarterly consolidated financial statements of the Company were prepared on basis of the annual audited financial statements of Montebello and unaudited half yearly and quarterly management accounts received from Montebello's management. At the end of the financial year in 2012, on the basis of annual audited financial statements of Montebello, provision for impairment to the extent of Rs.1,125,597,650 was provided in the Accounts of the Company. Since 2012, the operations of Montebello declined due to aggravated economic recession. In view of this, the Company's management hired independent Chartered Accountants to prepare projections for Montebello operations to assess fair value of



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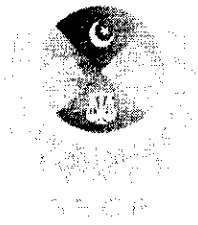
Montebello investment appearing in the books of the Company. In the year 2013 and 2014, provision for impairment was adjusted in the books of the Company in line with the recommendations of the Chartered Accountant Firm. Impairments were determined based on calculations of fair value of investment of Montebello. The fair value was determined using the Discounted Cash Flow method (DCF) which took into account the potential of future earnings of Montebello. Impairment adjustments for years 2013 and 2014 were booked for an amount of Rs.39 million and Rs.11 million based on reports of the Chartered Accountant Firm on prospective financial information. The business operations of Montebello continued to show a downward trend in 2014 and as per Montebello's management in Italy, it was due to the prevailing economic conditions in Europe. The Company was aware of such economic situations from market sources and no immediate follow up was considered necessary by the Company. Montebello's management in Italy advised the Appellants in late 2014 to hold exports as they were facing issues in recoveries from the customers in the normal course of business and, therefore, the Appellants temporarily discontinued exports to Montebello. It should be noted that the management of Montebello kept the Appellants updated on the situation of recoveries but never disclosed anything about the bankruptcy proceedings. However, it was in the month of September 2015 that the Appellants learnt through some former employees of Montebello that matters of Montebello had worsened and not been managed properly. Montebello's management including the director/CFO left without any proper notice or communication. The Appellants immediately contacted their legal counsel and instructed them to obtain all necessary details and orders relating to bankruptcy proceedings of Montebello. There was, therefore, never any false statement on part of the Appellants regarding Montebello and the Company adequately disclosed whatever material information it possessed. Further, it is pertinent to mention that it has been more than 10 years since the Company was listed in the Pakistan Stock Exchange and it has complied with all the requirements since listing.

- b) The Respondent alleged in the Impugned Order that the Appellants have violated the provisions of section 492 of the Ordinance and has accused the Appellants of

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“willful” concealment under section 492 of the Ordinance. The Respondent, however, has provided no reasons for the same and there was no element of willful concealment by the Appellants. All the allegations made by the Respondent are without substance, baseless and misconceived. The Respondent while passing the Impugned Order failed to understand that ‘mens rea’ was mandatory ingredient of section 492 of the Ordinance which was needed to be established before imposition of penalty. However, in the present case, there was neither any mala fide on part of the Appellants nor was there any intention of the Appellants to mislead or defraud the public or any of its investors.

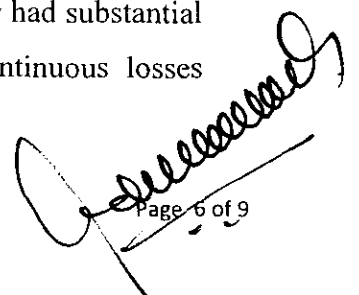
- c) The Appellants followed IAS and duly complied with all applicable laws and regulations to the best of their abilities. There has been no specific deviation from IAS 36 or IAS 39 as mentioned in the Impugned Order. The Respondent did not clarify how the Appellants fell short of market practice. There is no specific violation of the aforementioned clauses. The discrepancies which are listed in the Impugned Order are simply based on general terms and norms.

6. The Respondent rebutted the arguments of the Appellants as follows:

- a) The Appellants were penalized after establishing the case of violation of section 492 of the Ordinance. IAS 36 contains a provision which requires assessment of impairment of Company’s investment in Montebello and recording appropriate amounts of impairment in the Accounts. Bankruptcy of Montebello was filed on 12/06/14 and appointment of trustees for Montebello was made on 22/12/14. The plea of the Appellants that the management came to know about the aforesaid proceedings against Montebello in September 2015 i.e. after fifteen months of filing bankruptcy proceedings in the court, was not tenable. The Accounts for the year ended 30/06/14 and subsequent periods did not disclose the material facts about Montebello and filing of bankruptcy proceeding against it. Montebello was a wholly owned subsidiary of the Company and in all probability the Company’s management was aware of the circumstances of Montebello in which the Company had substantial investment which was being impaired over the years due to continuous losses


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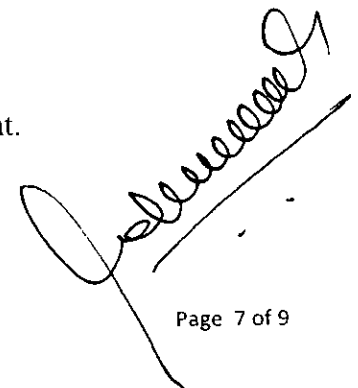
incurred by Montebello. Montebello's management was appointed and must have been guided by the Company's management. The Appellants as directors of the Company owe fiduciary duties towards the Company and it is one of their primary responsibilities that they must exercise care in discharge of their responsibilities to oversee the performance of all the investments of the Company and to safeguard all its assets. The Company's investment in Montebello was an equity investment and not in the nature of a loan or advance whose recovery was dependent on the performance of Montebello. The Company by virtue of owning the entire shareholding of Montebello was in control of its affairs through the board of directors who were nominees of the Company's management. In all likelihood, the Appellants must have had the knowledge of affairs of Montebello, however, they failed to disclose and appropriately reflect the impact in the financial statements of the Company.

- b) Section 492 does not set a strict test to prove that the default was willful for imposition of penalty, as is apparent from the bare reading of the section. In case of misstatement, no such test has been set. Mens rea need not be established in respect of proceedings under the provisions of the Ordinance, which only provide for pecuniary fines. In case of omission of material facts, section 492 of the Ordinance outlines two conditions i.e. (i) there is omission of material fact; and (ii) the person responsible for omission knew about materiality of the fact. Only knowledge of the materiality of the omission of material facts is to be reasonably established.
- c) The applicable international accounting standards require assessment of impairment of assets based on information available from internal as well as external sources and reflect the impairment of assets in the financial statements. The Appellants have failed to make full disclosure and record adequate impairment on investment in Montebello disclosed in the Company's Accounts, as per requirement of applicable IAS. Therefore, there was omission of material facts and the Accounts were misstated.

7. We have heard the parties i.e. the Appellants and the Respondent.


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8. The Appellants' Counsel have argued they had not omitted to reveal the bankruptcy of Montebello in the Accounts for the year 30/06/14 and interim accounts ended 30/09/14, 31/12/14 and 31/03/15 as knowledge of the bankruptcy proceedings only came to their knowledge in September 2015. At the hearing, the Counsel also relied on the email correspondence dated 15/09/15 and 16/09/15 between the Company's management and the management of Montebello to substantiate the claim that the Company was unaware of Montebello's bankruptcy proceedings. Furthermore, there was no mens rea or willful concealment and the Appellants cannot be penalized under section 492 of the Ordinance. The Respondent has rebutted this argument by stating that it is impossible that the Appellants being directors of the Company were not aware of the circumstances of its subsidiary i.e. Montebello and failed to make full disclosure and record adequate impairment on investment in Montebello in accordance with IAS 36 and IAS 39.

9. We are of the view that the Appellants have themselves acknowledged that from the year 2012 onwards, the operations of Montebello had declined due to economic conditions. In the instant case, the Company not only knew that the situation was grave but had worsened and could have made every effort to find out about Montebello's bankruptcy proceedings. It is also almost impossible to believe that for fifteen months after Montebello had filed for bankruptcy, the holding Company had no information about the status of its subsidiary. At the time of application for exemption from consolidation of accounts under section 237 of the Ordinance was made i.e. on 30/09/15, Montebello had already been declared bankrupt and ceased to exist yet the Company makes the extraordinary assertion that it had not known about its status. Even for argument's sake if it was true that the Company had not known the status of Montebello, it is still the fiduciary responsibility of the directors of the Company to make all efforts necessary to be fully aware of the circumstances and status of its subsidiary at all times. Mens rea has been defined in Black Laws Dictionary as "*the state of mind that the prosecution, to secure conviction, must prove that a defendant had when*



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committing a crime; criminal intent or recklessness. The word “willful default” has been defined in Oxford Dictionary of Law Fifth Edition as “*The failure of the person to do what he should do, either intentionally or through recklessness.*” The argument of the Appellants that the default under section 492 of the Ordinance was not willful or there was no mens rea holds little merit as even though there may not be knowledge or intent, the Appellants had not exercised due skill and care required of them as directors of the Company. We are of the view that the penalties were rightly imposed on the Appellants under section 492 of the Ordinance.

10. In view of the above, we see no reason to interfere with the Impugned Order. The Impugned Order is upheld with no order as to costs.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SCD)

Announced on: 28 SEP 2016